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INTERNATIONAL CITY MANAGERS' ASSOCIATION
1313 EAST 60TH STREET – CHICAGO 37, ILLINOIS

COST-OF-LIVING PAY ADJUSTMENT PLANS

What cities use a cost-of-living index as a basis for making pay adjustments for city employees and how are such plans operated?

Municipal officials are showing much interest in adopting some plan of adjusting the salaries of city employees to changes in the cost of living. The consumers' price index for August 15, 1947, stood at 160 as compared to the 1946 average of 139.3 and the 1940 average of 100.2 for 34 large cities (1935-39=100). The object of a cost-of-living adjustment plan is to adjust predetermined salaries to ups and downs of the economic cycle. It does not determine salaries nor does it take the place of merit increases; it only adjusts salaries after they are determined. In general, the plan is a helpful solution to municipal financing and seems to work well in most of the cities where it has been adopted. Various means can be used to keep the total cost within the financial capacity of the city. It is highly important that such a plan should not be confused with base pay and that it should not be used as a substitute for a pay plan.

The first city to adopt such a plan was St. Paul in 1922. At least 15 other cities have adopted similar schemes since 1940: Brookline, Massachusetts; Lynwood and Ventura, California; Albert Lea and Duluth, Minnesota; Colorado Springs, Colorado; Dearborn and Jackson, Michigan; Portland, Oregon; Phoenix, Arizona; Milwaukee, Madison, Merrill, Shorewood, and Whitefish Bay, Wisconsin. With the exception of Dearborn all cities apparently have kept up with the rapid rise in the cost-of-living index. All of the cost-of-living plans now in effect have been set up by ordinance rather than in the charter. Two cities have discontinued their cost-of-living pay adjustment plans. Columbus, Ohio, dropped its plan in 1944 after two years' operation because of the poor financial condition of the city, and San Diego took such action in 1946 when positions were reclassified and a pay plan was adopted.

If a city has a good position classification and pay plan, the question of pay increases is mostly a matter of over-all increases to meet rising living costs. Sound position classification and pay plans provide assurance that the pay schedule is internally equitable and consistent, that employees are not overpaid or underpaid in comparison with fellow workers performing the same duties, and that there is an equitable relation between the different classes of positions. Such plans also insure that existing pay rates for specific positions are not out of line with those paid in other comparable employments as determined by a survey of prevailing rates paid for comparable work in private industry and by local governments in the area and also by selected cities of approximately the same size and type. If a city has done these things, the next question is to determine how much living costs have increased in the city or area and to what extent the city is financially able to keep up with these increases. The pay plan of course must be kept up to date.

An analysis of the cost-of-living pay adjustment plans now in effect, presented below under five headings, may be useful to city officials in adapting the suggested ordinance (appended to this report) for local application:

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1. Base Salary. The cost-of-living plan should be based on an equitable pay schedule, as indicated above, so that the two distinct elements of base pay and cost-of-living adjustment will not be confused. Jackson, Michigan, for example, established base pay rates by ordinance on January 1, 1942, and added 10 per cent to the base pay July 1, 1945. Whitefish Bay, Wisconsin, fixed base pay for various titles as of August 1, 1945.

2. Index Used. All except one city (Brookline) use the "consumers' price index for moderate-income families in large cities," formerly known as the "cost-of-living index," of the United States Bureau of Labor Statistics. The index measures average changes in retail prices of selected goods, rents, and services, weighted by quantities bought by families of wage earners and moderate-income workers in large cities in 1934-36. The items priced for the index constituted about 70 per cent of the expenditures of the city families whose income averaged $1,524 in 1934-36. The index shows changes in living costs as compared to the base years 1935-39=100. The index is computed monthly for 10 large cities and quarterly on a rotating basis for each of 24 other cities. The Bureau makes available on request mimeographed tables showing indexes for most of these 34 cities since World War I. Smaller cities use the index figure for the nearest of the 34 cities. Albert Lea, for example, uses the Minneapolis index, Shorewood the Milwaukee index, etc. Brookline uses the index of the state department of labor and industries.

3. Number of Adjustments. The number of adjustments per year ranges from a single adjustment to no limit, and in most cities no adjustment is made unless the index changes one or more points. Cost-of-living pay adjustments are made annually in Albert Lea, Portland, and St. Paul if there has been a change of 2 per cent or more in the index from the preceding year; annually in Milwaukee (also by the county, sewerage commission, vocational school, and school board, all of which have the same plan) if the index has changed more than one point; annually in Duluth and Phoenix if the index shows a change of 2½ per cent; annually in Jackson if there has been a change of 5 per cent or more since the previous adjustment; and semi-annually in Madison and Merrill if the index changes one or more points. Whitefish Bay in July, 1947, abandoned annual adjustments in favor of a quarterly change, provided there has been a change of more than one point; when the index drops to or below 127 per cent the city will go back to making adjustments on an annual basis. Brookline adjusts salaries monthly if necessary and Shorewood adjusts whenever the index shows a change of five points or more.

4. Amount of Adjustment. Most plans provide for a definite maximum adjustment in any one year. But during the last year the index has changed 20 points or more, and for this reason Milwaukee removed the 10-point limitation on annual increases. Brookline, St. Paul, and Whitefish Bay likewise place no restriction on the amount of the adjustment made in any one year. When Whitefish Bay resumes annual adjustments a 10-point annual limit will be observed. Madison limits the adjustment for any six months' period to five index points, but any portion of the adjustment not made because of the limitation will be carried over in calculating the adjustment for the next six months' period. A five-point annual limitation can bog down a cost-of-living salary plan, particularly when a 20-point rise occurs as was the case this last year. Complaints may be made by employees against the plan unless more substantial adjustments can be effected.

In addition to the point or percentage change (identical when base is 100) in the index, three cities add extra points because the President's Committee

on the Cost of Living "estimated that because of quality deterioration, disappearance of cheaper goods, and other factors, the consumers' price index understated the rises in the retail prices of living essentials by three to four points between January, 1941, and September, 1944, for the larger cities and an additional one-half point for small cities." The Stabilization Director in December, 1945, made an allowance of 4.5 points for large cities and five points for large and small cities combined. Most of this point adjustment is no longer justified as merchandise of prewar quality and quantity is again generally available so that direct comparisons with prewar prices are made in computing the index. Milwaukee, for this reason, recently amended its ordinance to provide for adding only $2\frac{1}{2}$ points for such deficiencies in 1948 instead of the five points added this year. Colorado Springs and Whitefish Bay still allow five points.

5. Computing the Adjustment. Cost-of-living adjustments are automatic, made at a specified time, but the method of computing the amount varies from city to city. One method is to apply the full effect of the index change on some definite salary, and on all salaries below that amount, for full-time employees paid on a monthly or annual basis. In Milwaukee, for example, the adjustment is based on an annual salary of $1,620, or $135 per month. The rate of adjustment each year is the difference between the index for Milwaukee as of August 15 and the base of 100 for the period 1935-39. The index last August 15 was 159 plus $2\frac{1}{2}$ points for certain deficiencies (as explained above), making 161.5 index points or 61.5 per cent above the base of 100. Sixty-one and one-half per cent of $135 equals $83.02, the monthly cost-of-living adjustment.

Under the Milwaukee plan the employee who receives $83 per month base pay thus receives an adjustment of 100 per cent, but the employee who receives $415 per month gets an adjustment of only 20 per cent on his base salary. The dollar amount in each case is the same, $83.02 per month. The adjustments will rise or fall if the index goes up or down. Likewise, in Colorado Springs, Duluth, Portland, and Shorewood the percentage change applies only to the first $100 or less of monthly salary, and in Whitefish Bay and Phoenix to the first $135 or less. Since July 1, 1947, Madison makes a uniform adjustment of $58 per month. The methods used in these cities may not be true cost-of-living adjustment plans but they can be defended because of the need for substantial salary increases to the lower-paid groups, and at the same time provide some adjustment for higher-paid groups. But when the index goes down the lower-paid groups also feel the full effect of the decrease.

Another plan is to apply to the actual base salary the difference in the number of points between the base index and the current index. Apparently, Albert Lea is the only city using this plan, although Brookline uses it on salaries up to $133 per month. Still another method is to apply the full effect of the change in the index on a maximum salary, with the adjustment applicable to all employees receiving that amount or less, and in addition, to apply some part of the index change to the amount of salary received in excess of this maximum. Jackson applies the full amount of the change to basic salaries up to $1,500 per year and to hourly rates up to 75 cents. The amount of the salary in excess of these figures is adjusted by applying 50 per cent of the change. Thus on July 1, 1947, the city granted a 15 per cent adjustment on the first $1,500 or less of base pay and on the first 75 cents of hourly wages. One-half of the raise, or $7\frac{1}{2}$ per cent, was applied to the amount of the salary in excess of the $1,500 annual and the 75-cent hourly wages. St. Paul applies the full adjustment to the first $105 or less of the base rate with decreasing percentages applied to higher salaries up to $385 per month. During the first half of 1947 Madison also applied the full adjustment to salaries of $135 a month with a decreasing percentage of change for higher salaries.

A true cost-of-living plan, like the one in Albert Lea, or a graduated plan of the St. Paul or Jackson type, permits more than a token adjustment for salaries in the higher brackets. This is desirable because when the index goes down there will be pressure, as during the depression of the 1930's, to reduce the higher salaries -- forgetting that such salaries did not similarly benefit from increases in boom times. The proportion of the adjustment to be applied to the salary over the limit can be set at any reasonable percentage, but always within the city's ability to finance.

Most cities apply the cost-of-living adjustment to the pay of all employees. Several cities, however, make special provision for daily and hourly rate workers. Thus Milwaukee provides that "employees who work less than full-time shall receive a proportionate part of the cost-of-living adjustment in the same ratio as their part-time employment bears to the full-time employment." Whitefish Bay provides that per diem employees shall have their pay for each day adjusted by a sum equivalent to 1/250th of the annual "family maintenance income" of $1,620 and hourly workers by a sum equivalent to 1/2,080th of $1,620 "multiplied by the difference expressed percentage between the cost-of-living index and 100 calculated to the nearest even cent." Phoenix provides that per diem employees' pay is to be adjusted by multiplying the amount of change in the index by .65 of one cent. Thus a 15-point change times .65 of one cent amounts to a 10-cent-per-hour increase.

Conclusion. The administration of a cost-of-living adjustment plan is not difficult although the explanation of such a plan may sound involved. By applying several methods to the local base salary schedule it is possible to estimate costs and adopt a plan that is within the financial capacity of the city. The St. Paul plan has worked reasonably well for 25 years but it is a complicated plan and the adjustment and the salary schedule seem to be closely interwoven, which is not desirable. The Milwaukee plan, like most other plans, bases the adjustment on a single salary. This benefits the lower paid employees most when the index goes up but it also penalizes them when the trend is downward. The diminishing percentage adjustment for higher salaries, as provided in the St. Paul and Jackson plans, probably is preferable to a plan which applies the adjustment to only a fixed amount of pay.

When the index goes down will employees be willing to accept an automatic downward adjustment? From 1922 to 1940 St. Paul employees accepted reductions totalling 29 points and increases of 14 points. Since 1940 the adjustments have amounted to an increase of 66 points. Some labor groups are opposed to a cost-of-living plan because it operates automatically; the union cannot take credit for securing increases and is more or less helpless when the index goes down. Other labor groups, however, have found it a good method for settling annual salary changes with a minimum of friction.

Whatever adjustment feature is adopted it should be looked upon as an addition to a pay plan and not as a substitution. The danger to be avoided is a tendency to regard cost-of-living adjustments as sufficient for continued maintenance of the pay plan. A final warning is that cost-of-living adjustments do not reflect the fundamental problems raised by material increases or decreases in rates paid for comparable classes of work by private employers or other public agencies in the vicinity. It is essential to carry on periodic salary surveys to ascertain relationships between the city as an employer and the employers in the vicinity in order to determine whether rates for specific classes of positions or of specific levels of salaries should be revised.

SUGGESTED COST-OF-LIVING SALARY ADJUSTMENT ORDINANCE

Sec. 1. Cost-of-Living Adjustment. The base salary of each officer and employee as defined in Section 2 shall be adjusted semi-annually starting (insert date annual budget) in the annual budget in accordance with the changes in the cost of living. The proper city officials shall determine and compute the adjustment on the basis of the change in the index as indicated in this ordinance, and this adjusted amount shall be added to the base pay of each officer and employee covered by the terms of this ordinance until the next adjustment is made.

Sec. 2. Base Salary. The base salary schedule shall be the salary schedule in effect on (insert the month and year) together with such step increases (or other designation) which are a part of the adopted salary schedule. This base salary schedule shall remain in full force and effect until replaced with a new base salary schedule determined as provided in Section 7 of this ordinance.

Sec. 3. Index. The cost-of-living index to be used is the Consumers' Price Index of the Bureau of Labor Statistics of the United States Department of Labor for the city of ________________, and the increases or decreases that are computed shall be known as cost-of-living pay adjustments. The base figure shall be the index number used as a base (1935-39=100) by the United States Department of Labor.

Sec. 4. Semi-Annual Adjustment. All cost-of-living salary adjustments shall be effective semi-annually, the first adjustment to be made on January 1, 1948, and thereafter on each January first and July first. The criterion for the January adjustment shall be the index for the preceding month of ___________, and the criterion for the July adjustment shall be the index for the preceding month of _________.

Sec. 5. Method of Computation. The difference in the number of points between the base index and the current index shall be used as a percentage adjustment applied to the actual base salary received up to and including $1,800 per year (or other amount of maximum salary) and on that amount for salaries above this maximum. No adjustment shall be made unless the index has changed two points or more from the index used to effect the last previous adjustment, provided that in no event shall a semi-annual adjustment, after the original installation, be made for more than five points. If this limitation becomes operative then the portion of the cost-of-living adjustment in excess of five points shall be considered in calculating the cost-of-living adjustment for the next adjustment date. The initial cost-of-living adjustment under this ordinance shall be $_________ per month.

[Note: Under section 5 as worded, an employee who receives a base salary of $1,200 would get a monthly adjustment of $4 on a four-point rise in the index, an $1,800 salary would get $6 (4 per cent of $150) and a $2,400 salary (or any other salary over $1,800) also would receive a $6 adjustment. Alternative Plan A: Delete "and on that amount for salaries above this maximum" and add: "except that, in addition to the above, one-half (or other desired percentage) of the change so applied shall be computed on the amount of the salary above $1,800. Comment: Under plan "A" an employee would receive $6 on the first $150 of monthly pay (same as under section 5 above) but on the next $200 of a $350-per-month salary, for example, he would receive $4 additional--one-half of a four-point change is two points and 2 per cent of $200 is $4. Alternative Plan B: Delete first sentence of section 5 and insert "The cost-of-living adjustment

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for all regular employees, regardless of the amount of compensation actually received, shall be based upon a salary of $_________ per year." Comment: Under plan "B" the employee receiving $100 per month, as well as the employee receiving $500 per month, would receive an adjustment of $6 per month on a four-point change in the index, if the maximum base salary is $1,800 (4 per cent of $150 per month). Other variations of these plans can be worked out.]

Sec. 6. Part-Time Employees. Wages of per diem and hourly employees, or wages of those on other than an annual basis, or of those who are not regularly employed throughout the year, shall not be subject to a cost-of-living adjustment, unless the council elects to include any or all such employees, in lieu of any other annual determination or negotiations of salaries or wages. Then employees who work less than full-time shall receive a proportionate part of the cost-of-living adjustment in the same ratio as their part-time employment bears to full-time employment. No salary adjustment shall be made on an overtime payment.

Sec. 7. Revision of Base Pay. Each five years the personnel director shall make a survey of comparable salaries paid by other business and industrial concerns in the city together with such other information as would be of aid in determining the equity of city salaries, including an estimate of the value of pension plans, tenure, working conditions and other factors in the municipal service which should be considered in establishing salaries. The council shall then, after a public hearing, order such changes in the base salary schedule which in their judgment are necessary so that city employees shall be paid on a comparable basis both between the different branches and with those prevailing in private business and industry.

Sec. 8. Penalties. The (insert name of the disbursing officer of the city) shall not authorize any salary check or other disbursement of city moneys for salary or wages of any employee subject to this ordinance, which has not been properly adjusted by the (insert name of the agency responsible for preparation of the annual budget) in accordance with the provisions of this ordinance. Any officer who authorizes or permits such disbursements in excess of those authorized by this ordinance shall be subject to removal from office by the appropriate appointing authority.

Sec. 9. Exceptions. Nothing in this ordinance shall prevent the standardization of salaries within the five-year period provided for regular revision of base salaries nor shall it prevent transfer of employees from per diem pay to regular salary, provided, however, that no such standardization or transfer from per diem workers shall constitute an upward revision of the salary schedule to increase the base salaries.

Sec. 10. Exemptions. The provisions of this ordinance shall not apply to any elected official; or to any officer whose salary is established by law through charter or statute; or to part-time members of boards or commissions; nor to any officer or employee remunerated on a fee basis; or to any person or firm working for the city on a contractual or temporary basis.

Note: Cities subscribing to MIS may secure on request (1) the Madison and Milwaukee, Wisconsin, cost-of-living adjustment ordinances, (2) a list of the 34 cities for which the Bureau of Labor Statistics prepares price indexes, and (3) information on the graduated feature of the St. Paul plan. Certain pay data are available in the 1947 Municipal Year Book (pp. 107, 111, 335, and 337.) Information on position classification and pay plans may be secured on request to the Civil Service Assembly, 1313 East 60 Street, Chicago or to MIS.